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Consumer Packaged Goods' Trade Balance Continues to Decline - Is the Canadian CPG Industry in Trouble?

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July 2014

There has been a great deal of research done regarding Canada's deteriorating trade balance in Agri-Food products. For example, the Canadian Agricultural Policy Institute (CAPI) has noted that the secondary processed food sector has a rising trade deficit. In 2004, the trade balance was negative $1 billion. As of 2013, the deficit reached negative $6.8 billion (2013 data). CAPI has stated that while Canadian processed food exports stalled over this period, imports rose steadily. CAPI goes on to note that processed food is the only group in the entire food and agriculture sector with a net trade deficit. Overall, the commodity sector has a positive trade balance.

The George Morris Centre has also been exploring the trade balance in processed food and assessing its implications. The Centre has focused on trade with the United States. In the May edition of Grocery Trade Review, it was noted that Canada's net trade balance in processed food and beverages with the United States was negative in the first quarter of 2014, compared to 2013. In other words, the erosion has continued into 2014.

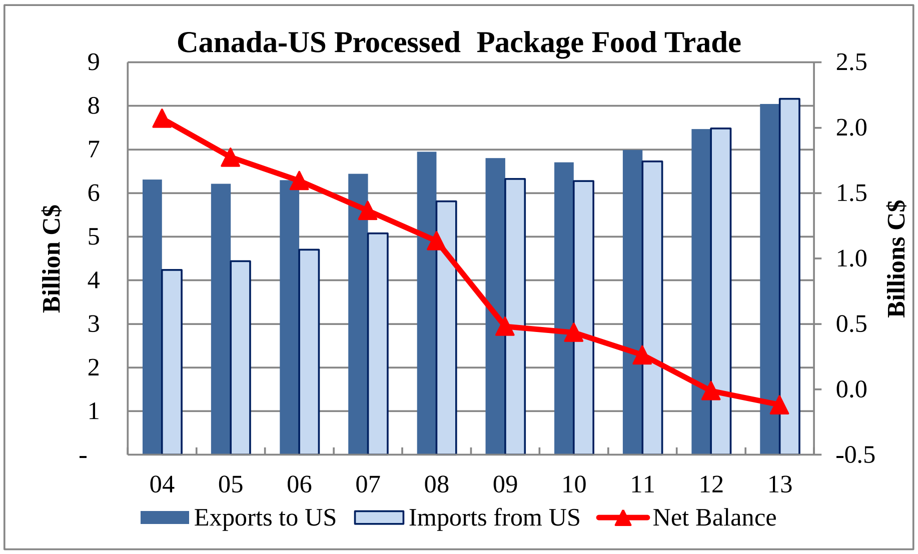
The purpose of this paper is to examine the consumer packaged goods (CPG) trade with the United States. The CPG sector is a narrower part of the food industry but it is very visible, high profile and high value-added. It is the branded food sector in the centre of the grocery store. By examining the CPG trade performance with the United States, this paper seeks to determine the ramifications as well as the opportunities and challenges.

Definitions and Trends

In this paper, the processed food and beverage definition is based on the U.S. Foreign Agricultural Service (FAS) and does not include alcoholic beverages or seafood. Further to that, the US FAS data set provides the ability to strip down the categories being reported to isolate sectors or groupings. The FAS processed food can be defined without non-alcoholic beverages, animal foods, oils, prepared meats and dairy. As such, the overall grouping is reflective of the typical consumer packaged goods (CPG) in found in the center of the grocery store.

The rest of this discussion focusses on the CPG trade sub-segment of the overall processed food and even larger agri-food trade.

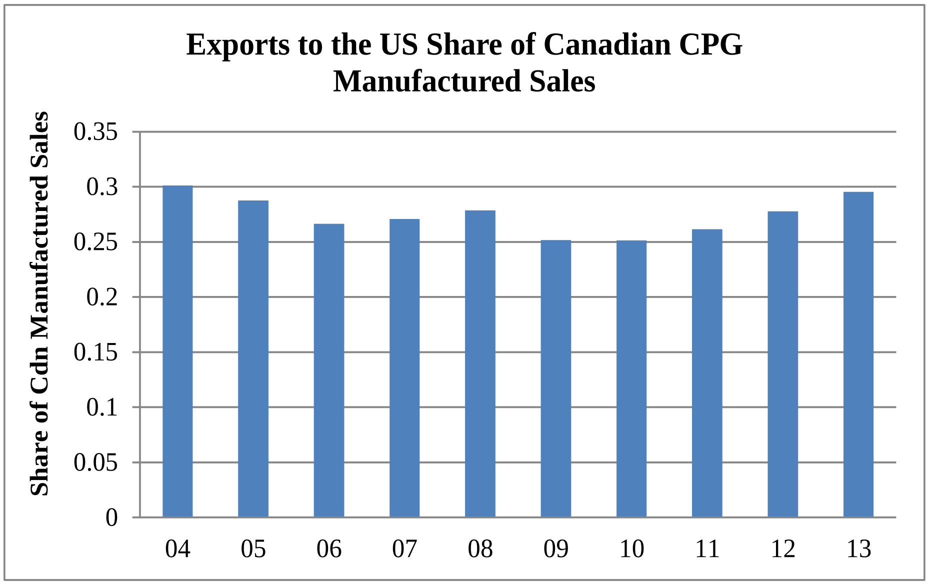
The trade balance in CPG has been eroding over the past ten years and the net between Canada and the U.S. turned negative in 2012, and more so in 2013. The balance has not been as poor as the overall processed trade discussed above, but the trend is negative.



Of course, even when narrowed down to CPG, there are multiple sectors or industries within that broad grouping. Each of those industries and businesses has a unique performance. For example, Canada has enjoyed a steady and positive trade balance in processed vegetables and pulses over the past six years. The balance in snack foods has been positive, but it has been eroding. Condiments have generally been negative, but further eroding over recent years.

Domestic Market Share Performance

The question of the trade balance with the U.S. logically leads to the issue of the Canadian export and domestic market share for Canadian manufacturers of CPG's. Taking Canadian CPG manufacturer sales as reported by Statistics Canada and comparing the US FAS export sales figure can give an indication of the importance of the U.S. market to Canadian CPG manufacturers. Using that methodology, Canadian manufacturer exports of consumer packaged food goods to the U.S. has amounted to about 25- 30% of their total Canadian sales over the last several years. More recently, the share increased from 25% to 30% of total sales from 2009 to 2013.

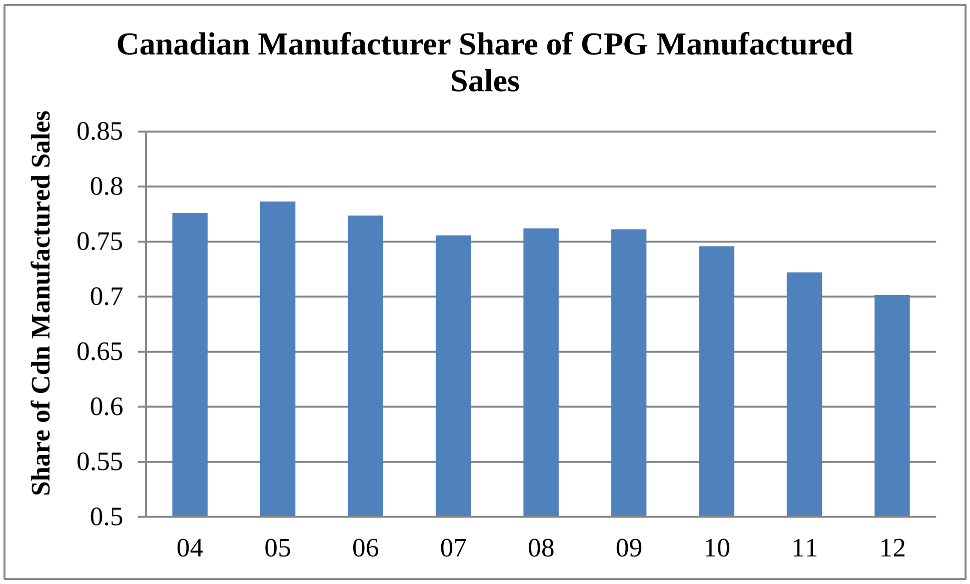


It is also of great interest to look at the U.S. share of the Canadian manufactured CPG food market. The flip side of that U.S. share of the Canadian market is the Canadian share of the Canadian manufactured food market. In this instance, the Canadian manufactured CPG food market will be defined as follows:

Statistics Canada Canadian manufactured consumer goods sales, minus the U.S. FAS sales exported to the U.S. plus the U.S. FAS food products imported into Canada.

That is not an ideal definition because it does not exclude the packaged goods that are exported to third countries from the defined Canadian domestic market sales. With that acknowledged the data tabulation is consistent and that third country share is not likely to be material relative to the U.S. and Canadian shares.

As noted above, U.S. imports of manufactured packaged foods into Canada has been increasing. That increase has resulted in the U.S. share of goods in the Canadian packaged foods market rising from about 23% in 2004, to about 30% in 2013. Conversely, and flipping that over, the Canadian share of Canadian manufactured food market sales has declined from about 77% to 70% in the ten years from 2004-2013.



The loss of domestic market share should not be surprising to anyone given the much publicized plant closures in the consumer packaged goods industry. A Canadian Agricultural Policy Institute study earlier this year examined food plant closures and associated issues. The CAPI study conducted by the Ivey School at Western, found that between 2006 and 2014, 143 Canadian food plants closed. During that period, 63 new plants opened and 67 companies announced major investments. The study, entitled "The Changing Face of Food Manufacturing in Canada: An Analysis of Plant Closings, Openings and Investments" also said that openings and major announced investments exceeded closures. One very interesting aspect of the study said that foreign-based firms were much more likely to consolidate or restructure while Canadian ones were more likely to restructure and invest. The study said that the majority of the foreign activity in Canada is through U.S. companies, with closures substantially outnumbering openings and investments. Canadian firms had a greater tendency to make changes to existing facilities through consolidations or investments.

In any event, it is clear that even though openings and major announced investments exceeded closures as stated in the study, it did little to stem the market share loss that Canadian firms are experiencing. Furthermore, it seems obvious that the U.S. closures of Canadian plants have had a big impact on the share and trade balance erosion.

Why It Matters

This erosion of both domestic and export market share is symptomtic of a lack of competitiveness of the Canadian CPG industry. There are other factors at work, however, that do not necessarily mean that Canada is in danger of continual decline. Needless to say, these developments are important to the industry participants as the nature and terms of trade transactions are impacted. On a larger scale it is important because value added jobs, research efforts and marketing expertise are jeopardized or lost.

The following are some points for consideration.

1. Canadian retailers are good buyers and they like to maximize their buying options. Canadian retailers will use U.S. sourced product as a tool to leverage against vulnerable Canadian producers, who have fewer selling opportunities than their larger U.S. competitors.

2. It should also be pointed out that a lot of Canadian capacity in CPG categories is used for private label production, sold either in Canada or the U.S.. Most big brands are U.S. based and supplied in Canada from U.S. production facilities. The Canadian consumer is indifferent or unaware of manufacturing source, whether branded or private label.

3. There a number of factors which inhibit Canada's ability to penetrate the U.S. market. One of these is scale. The U.S. food retail arena has shifted by channel away from regional supermarkets, and more into national mass merchandisers, club stores, and dollar stores. Thus Canadian plants, once built for domestic consumption ,lack the scale to supply those outlets in any meaningful way. Yet the U.S. manufacturers typically have the scale to supply Canada.

4. It matters that Canada maintains a robust CPG manufacturing sector. In order to do so, companies need to grow beyond the traditional Canadian supply for Canadian consumption model. Those days are over. Indeed, Canadian retailers cannot and will not buy locally if quality and price do not meet U.S. offerings. Nor will Canadian consumers behave that way.

A version of this report first appeared in the George Morris Centre publication, Grocery Trade Review. If you would like a free two month trial subscription to Grocery Trade Review please e-mail kevin@georgemorris.org

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